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SUBJECT: EAST JAVA MUDFLOW UPDATE: FULL ECONOMIC IMPACT  
DIFFICULT TO QUANTIFY

REF: SURABAYA 26 (AND PREVIOUS)

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ACCORDINGLY.

11. (SBU) Summary: During EAP Deputy Assistant Secretary Scot Marciel's visit to the Sidoarjo mudflow site, the site manager expressed confidence that current efforts were mitigating the risk to surrounding areas, but warned about possible seismic activity. Local economic experts were universally critical of government efforts to address the impact of the mudflow on surrounding neighborhoods and businesses, despite positive growth numbers. Minimal government money has been allocated to relocate critical infrastructure and the mudflow management body is facing serious financial difficulties. The Japanese Consul General warned publicly about the mudflow's impact on East Java's investment climate. End Summary.

12. (SBU) On August 26, DAS Marciel, accompanied by two staffers from the House Foreign Affairs Committee, visited the Sidoarjo mudflow and received an update on operations from Sofian Hadi, Director of Operations for the Sidoarjo Mud Disaster Management Board (BPLS). Sofian told the visitors that the situation at the site had improved in the three-months since BPLS had been in operation, but would become more difficult when the rainy season began in November. He expressed concern, however, that recent increases in mudflow rates (currently at one cubic meter/second) and the emergence of new water geysers throughout the area signaled the near-term onset of seismic activity that could threaten the dams' integrity. He reiterated previous predictions that the flow rate of the Porong river during the rainy season would be sufficient to move the mud out to sea. Sofian admitted that financial concerns threatened operations, mentioning that he had not been paid in three months. (Note: We understand that although BPLS is a government body, the Lapindo company is responsible for paying the bills.)

13. (SBU) In a August 26 lunch with DAS Marciel, six local economic experts painted a contradictory picture of the impact of the mudflow on East Java's economy. According to Indra Nur Fauzi, Managing Director, Regional Economic

Development Institute, East Java's economic growth in 2006 was approximately 5.80%, down only marginally from 5.84% in 2005. He suggested that the numbers were somewhat misleading because there had been a significant shift from manufacturing to trading and services over the past year. The provincial government viewed this shift as a positive trend toward a more mature economy. The experts disagreed with this assessment, as the manufacturing sector had declined badly, forcing manufacturing workers and business owners to move into trading (primarily as importers of Chinese products). Kresnayana Yahya, Director of Enciety Business Consultants, said that the transportation sector had declined approximately 60% in the effected area, increasing costs to companies exporting through Surabaya's ports. Tourism in areas south of the mudflow had been hard hit, with occupancy rates in Malang's 28 hotels falling to less than 20% occupancy.

14. (SBU) All agreed that the government had failed to take a serious or comprehensive approach to deal with the mudflow's impact. Subagyo, a professor at Airlangga University, said that the government, for example, had only allocated Rp 600 billion (approximately USD 63 million) in 2007 to buy land for relocating infrastructure. Projected timetables to replace the toll road ranged from 2008 to 2010, even though construction had yet to begin. Yahya and Indra complained that BPLS did not have the budget or the authority to handle the problem. Yahya added that although the BPLS deputies responsible for social and infrastructure issues had many plans, they had no budget with which to implement them. The experts lamented that neither the central nor provincial governments had developed or implemented plans to offset the economic impact of the mud flow through tax breaks, rescheduled debts, economic incentives, fee waivers, etc.

15. (SBU) Representatives from Bank Indonesia noted that the  
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bank had taken steps to provide special treatment to members of the business community affected by the mud, but this policy was limited to only five municipalities and regencies.

Bank Indonesia is considering expanding coverage, but needs to evaluate carefully claims that the mudflow is responsible for business failures. While the Sidoarjo regency used to be a favored property location in East Java, customers are turning to other regions and property located miles from the mudflow fail to find buyers. They noted that some businesses have relocated to other areas in East Java or to Central Java/Jogyakarta where salaries are lower. Bank Indonesia reps referred to a "paradox of growth," where growth rates remained high, yet poverty and unemployment increased. Bank Indonesia statistics put East Java's second quarter growth at 6.01%, with expectations that export values will break records for the year.

16. (SBU) In separate conversations with Principal Officer and local media, the Japanese Consul General Yushi Suzuki complained that the mudflow was harming Japanese businesses and deterring Japanese investment in East Java. Most existing Japanese investors are located at the Pasuruan Industrial Estate Remang, located just south east of the Sidoarjo, and are thus experiencing serious delivery disruptions. According to the East Java Investment Board, although Japan traditionally ranks fourth in East Javanese investments (after Taiwan, South Korea, and China), in the first six months of 2007, there has been no new Japanese investment. According to the investment board, Japanese companies have invested in 127 projects valued at USD 2.198 billion. Since January 2007, Japanese investment has been limited to expansions of existing projects, valued at USD 21.807 million.

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